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Q1 2020 US Well Services Inc Earnings Call

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MAY 11, 2020 / 9:00PM GMT, Q1 2020 US Well Services Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the U.S. Well Services First quarter Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. It is now my pleasure to introduce your host Josh Shapiro, Vice President of Finance and Investor Relations. Thank you, Mr. Shapiro, you may begin.

Josh Shapiro ***U.S. Well Services, Inc. - VP of Finance & IR***

Thank you, operator, and good afternoon, everyone. We appreciate you joining us for the U.S. Well Services conference call and webcast to review first quarter 2020 results.

Joining us on the call this afternoon are Joel Broussard, Chief Executive Officer; and Kyle O'Neill, Chief Financial Officer. Following their prepared remarks, the call will be opened for Q&A. In keeping with best practices for social distancing, the team is joining this call from different locations, so please forgive any issues coordinating responses to your questions.

This morning, U.S. Well Services released its first quarter 2020 earnings. The earnings release can be found on the company's website at www.uswellservices.com. The company also filed its first quarter 2020 Form 10-Q with the SEC this afternoon. Please note that the information reported on this call speaks only as of today, May 11, 2020, and therefore, time-sensitive information may no longer be accurate as of the time of any replay listening or transcript reading. In addition, the comments made by management during this call may contain forward-looking statements within the meaning of the United States federal securities laws. These forward-looking statements reflect the current views of U.S. Well Services management. However, various risks, uncertainties and contingencies could cause our actual results, performance or achievements to differ materially from those expressed in the statements made by management. The listeners are encouraged to review today's earnings release and the company's filings with the SEC to understand those risks, uncertainties and contingencies. Also, during today's call, we will reference certain non-GAAP financial measures. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are included in our earnings release.

And now I would like to turn the call over to U.S. Well Services' CEO, Mr. Joel Broussard.

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Thanks, Josh, and good afternoon, everyone. The crude oil demand disruption resulting from the global COVID-19 pandemic has created the most challenging operating environment in the history of our industry. It should come as no surprise that hydraulic fracturing activity slowed sharply with some analysts estimating that there are as few as 50 frac fleets in operation versus approximately 350 at this time last year and approximately 250 at the beginning of this year.

Before I review the key highlights from the first quarter, I'd like to discuss USWS' response to these extraordinary challenges and what we are doing to best position the company moving forward. We began developing our response plan in late February as we monitored the spread of COVID-19. We started with steps to ensure the health and safety of our employees and customers as safety is our top priority. U.S. Well Services developed new operating procedures and distributed additional PPE, sanitizers and cleaning supplies to all shop and field locations to protect against the spread of the virus where we work.

We put screening procedures in place, including temperature checks prior to leaving hotels and man camps, and we are collaborating

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with all of our customers to ensure the well-being of everyone working at USWS wellsites. Well enabled are our corporate employees to work from home and will follow local guidelines for reopening nonessential business locations.

By early March, conversations with our customers shifted from safety protocols to concerns regarding declining global demand for crude oil and the potential implications it would have on their completions programs. In anticipation of challenging times ahead, we quickly and aggressively cut costs and moved to enhance liquidity. Since mid-March, we reduced headcount by over 55%, bringing total headcount to fewer than 425 active employees from nearly 1,000 employees at the end of February. We restructured our management team, eliminating layers overhead between our senior executive and field operation teams. Additionally, for remaining employees, we made across-the-board cuts to compensation and benefits starting with a 20% reduction in salary for senior management and our Board. Our procurement team is working with vendors to reduce the cost of all goods and services we use, and we will be strictly limiting capital expenditures to critical maintenance-related expenditures for the balance of the year.

Finally, and most importantly, we completed a capital raise that allowed us to amend our credit agreements, boosting liquidity and giving us substantial runway to work through this market downturn. Kyle will go through the specifics later, but the key points are that we extended the maturity date of both credit agreements to 2025 and suspended scheduled cash payments for principal and interest on our term loan for 24 months. As a result, our next scheduled payment on the term loan is June 30, 2022, preserving approximately $60 million of cash, principal and interest payments over that period.

The speed and the magnitude of this downturn has required us to take extreme action. This hasn't been easy, but our employees have stepped up to meet the challenge ahead on. Their hard work, dedication and ingenuity are what enables us to offer best-in-class service quality and technologically differentiation.

U.S. Well Services will emerge from the downturn stronger and poised to be an industry leader for the long-term. Our results for the first quarter of 2020 reflect the rollercoaster nature of the past several months. While the company faced challenges toward the end of the quarter, we started off the quarter from a position of strength. We deployed a new electric fleet in January to work for Shell and grew our active fleet count to 10.7 from 8 in Q4 of 2019. Our utilization picked up in January and February relative to Q4 levels before declining in March, resulting in an 84% utilization for the quarter or 8.9 fully utilized fleets. We grew revenue to $112 million from $93 million in the fourth quarter of 2019 and grew gross profit margins to 24% from 18% over the same period.

In early April, we finalized the contract to provide EQT with electric frac services for up to 3 years, assuming the exercise of all optional extensions. I want to congratulate my team for this huge win. This is a testament to our technology and operational capabilities.

U.S. Well Services generated $12.7 million of adjusted EBITDA in the first quarter or $21.8 million including a reserve for accounts receivables, which Kyle will touch on later.

Hydraulic fraction activity is likely to remain muted through the end of 2020 as the growing supply and demand imbalance for oil combined with severely depressed crude prices will likely force many producers to focus on shutting in production rather than drilling and completing new wells. With that said, we are adapting to the current reality and positioning of the company to succeed as market conditions improve. We began reallocating resources to the Marcellus region in early Q4 of 2019 to increase our exposure to gas basins and currently have 2 contracted electric fleets working in the area. Going forward, we plan to use a disciplined pricing strategy, and we'll focus on maintaining our technological advantages and operational efficiencies so that demand for our fleets remain strong as activity levels improve.

With that, I will turn the call over to Kyle, our Chief Financial Officer.

Kyle P. O'Neill ***U.S. Well Services, Inc. - CFO***

Thanks, Joel. Good afternoon, everyone. Revenue increased by 20% sequentially to $112 million, driven by an increase in the number of active fleets we had working during the quarter. Service equipment revenues increased 22% compared to the fourth quarter, and we also experienced a 23% sequential increase in the sale of consumables, including sand, chemicals and trucking services.

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Our cost of sales increased to $85.1 million or 12% when compared to Q4 2019, driven by activity levels and the cost of consumables sold to customers. Despite a 40% increase in pumping hours quarter-over-quarter and a change to our accounting policy to expense fluid ends, our repair and maintenance expense only increased 6% quarter-over-quarter.

SG&A totaled $19.1 million for the first quarter of 2020. As we evaluated the stress that the current commodity price environment has placed on the market, we made a decision to create an allowance reserve equal to approximately 10% of our outstanding accounts receivable. Excluding the accounts receivable reserve, severance and stock-based compensation, SG&A was $8.4 million for the quarter as compared to $6.1 million for the fourth quarter of 2019.

The increase was primarily driven by increased professional fees. The sudden and drastic decline in commodity prices also triggered an impairment review of our long-lived assets under GAAP accounting rules. As a result, we booked $148 million noncash impairment charge during the period.

U.S. Well Services reported adjusted EBITDA of $12.7 million for the first quarter of 2020, up 5% sequentially from $12.1 million. Reported adjusted EBITDA for Q1 includes the accounts receivable allowance discussed earlier. Excluding this -- the charge for that reserve, the company generated $21.8 million of adjusted EBITDA, which equates to $9.8 million of adjusted EBITDA per fully utilized fleet.

During the quarter, U.S. Well Services spent $23 million in CapEx, of which $13 million was related to the new electric fleet we deployed during the period. The balance was for maintenance CapEx. We do not expect to incur any additional growth CapEx during the year and expect maintenance CapEx to decrease as a result of fewer working fleets, the majority of which will be electric and other cost reduction measures initiated during the quarter.

As the impacts of the COVID-19 pandemic became clear, our team took swift action to rationalize our cost structure, targeting labor and compensation expense first. We reduced our workforce to align with current levels of activity. In conjunction with those layoffs, we cut pays starting with a 20% reduction in salary for senior management and the Board and reduced all other salaried and hourly employees paying by 10% and 5%, respectively. We suspended our 401(k) matching program. We made changes to certain other benefits and perks, including per diem expenses for field employees. In total, we believe these cuts will contribute approximately $75 million of annualized labor cost savings relative to last 12 months. These savings will be attributable approximately 90% to cost of sales and 10% to SG&A. We estimate that 45% is attributable to a reduction in the number of active fleets. And $30 million is attributable to restructuring and reorganization of our remaining employee base and compensation practices.

Additionally, we have been working proactively to reduce the cost of materials used, including critical components, spare parts and consumables. We are working to substantially reduce or eliminate costs associated with contract labor, rental equipment, professional fees and other overhead going forward. These cost reductions should contribute over $10 million on an annualized basis.

Finally, with respect to CapEx, we have canceled orders on approximately $11 million of fleet-enhancing equipment that would have been delivered throughout 2020.

As Joel discussed earlier, in an effort to boost liquidity and extend our runway, we issued $22 million of convertible preferred equity in April, which was used to fund fees and expenses related to concurrent amendments to our ABL and term loan. These amendments provide us with exceptional flexibility to manage through this down cycle by reducing the interest rate on our term loan to 0% and suspending scheduled amortization payments for 24 months, preserving over $60 million of cash over that same period.

We increased certain concentration limits under our ABL and added a FILO feature, which essentially increases the advance rate on our ABL facility, allowing us to access more of the borrowing base. Finally, we pushed out the maturity dates of both facilities into 2025.

In summary, U.S. Well Services has taken swift action to reduce costs, boost liquidity and position the company to not only withstand the current market turmoil, but to capitalize on future recovery.

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With that, I'll turn the call back over to Joel for concluding remarks.

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Thanks, Kyle. I would just like to thank our employees for their dedication and tireless efforts during this extremely difficult period. We would also like to express our thanks for everyone working hard on the front line and our communities to keep us safe as COVID-19 pandemic persists. The team at U.S. Well Services is cycle tested, and we are fully dedicated to making sure our company emerges from this crisis as a market leader.

Now, we'll turn it over to operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Stephen Gengaro with Stifel.

Stephen David Gengaro ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst***

I hope everybody is well. I guess there's 2 things I want to address. The first is, you signed a new contract with EQT. I believe that that put 4 of your fleets, 3 electric and a conventional under contract. Can you just talk about the -- those contracts? And is that a baseload of activity we should expect going forward? Or how should we sort of think about the utilization of the assets that are under contract?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Yes. Thanks for the question. Thanks for joining the call. It is a baseload. Those will be contracted at the end of the year and going into 2021.

Stephen David Gengaro ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst***

Is there a utilization dynamic within those contracts? Or will those 4 fleets be largely utilized throughout the year?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Largely utilized. One of them as a break in the fourth quarter, simply because we outperformed what they thought we were going to do on a stage -- on a pump hour per month basis, which is going to give us an opportunity to do some test trials for other companies that want to try the electric fleets. And then it kicks back off January 1.

Stephen David Gengaro ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst***

Okay. And then as we think about it, so I think you said there were -- I think you said in the press release there were 4 fleets working. I assumed it was those. But when you think about the thought process on putting additional fleets to work, is there a kind of an EBITDA per fleet floor? I mean is it a cash flow breakeven number we should think about that you put equipment back to work and remain popularized?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

No.

Stephen David Gengaro ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst***

How many fleets are actually manned at this point?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Yes. We have 4 fleets manned with 1 on furlough every other week. And we have -- we plan to put that 1 back to work evidently. And we're not going to work for cash flow breakeven, especially on electric equipment because they still -- we still have few -- we still are seeing some fuel savings even with the price of diesel as low it is. So I would imagine diesel fleet 8 -- $7 million to $10 million of EBITDA per fleet and electric should be $10 million plus.

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Operator

Our next question comes from the line of Daniel Burke with Johnson Rice & Company.

Daniel Joseph Burke ***Johnson Rice & Company, L.L.C., Research Division - Senior Analyst***

Maybe 1 for Kyle. Just impressive job with the effort on the ABL and the term loan in particular. Could you talk about liquidity, though, as this year advances? What level of account receivable relief do you expect? And then maybe address as well what that declining AR balance will mean for access to the ABL?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Kyle, go ahead.

Kyle P. O'Neill ***U.S. Well Services, Inc. - CFO***

Sure. All right, thanks. Sure, I mean we obviously went through a lot of different modeling scenarios and looked at worst-case scenarios and 50 different ways and sliced and diced it and that really is what led us to putting together this relief package that we're able to work out with our ABL and term loan lenders. And by removing that cash debt service for that period of time, we have an incredibly variable cost structure. And given kind of the baseload contract economics, we think that we can easily withstand any type of market going forward and be able to navigate any liquidity tightness over the next 24 months.

Daniel Joseph Burke ***Johnson Rice & Company, L.L.C., Research Division - Senior Analyst***

Okay. All right. That's helpful. And then maybe the only other one I had really, guys, was sort of to come back towards the 4 fleets that are active. And Joel, just to return to Stephen's question for a moment, I mean it sounded like here in Q2 at least based upon the visibility you will have that that you expect those 4 active fleets to be pretty much fully utilized? Is that the right conclusion?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Yes. Except in the fourth quarter, Shell will be taking a break because we outpaced their budget. But we don't see -- we're currently looking for 3 months of work for our test trial on a brand-new electric fleet.

Operator

Our next question comes from the line of Dylan Glosser with Simmons Energy.

Dylan Gray Glosser ***Simmons & Company International, Research Division - Analyst of Oil Service***

I might have missed this, but in regards to the contracts you guys have in place in the pricing within those contracts and the utilization moving forward through the next few quarters. As far as fleet profitability goes, can you just talk about your relative -- your ability to maintain a profitability that you guys have seen in the previous quarters with the remaining fleets that you guys have in place today?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Go ahead, Kyle.

Kyle P. O'Neill ***U.S. Well Services, Inc. - CFO***

Sure. I mean, I think the economics of those contracts had stayed the same. That being said, obviously, the business does have some fixed cost components. So overall, while we taken dramatic steps to reduce that fixed cost base, it is being spread out. Even though it's a lower total dollar amount, it is being spread out over 4 fleets, if you will. So I would expect to see some contraction in EBITDA per fleet. I think it would be a reasonable conclusion. But I think that it's going to -- having that -- having those contracts in place with key customers is a huge benefit, huge competitive advantage for us.

Dylan Gray Glosser ***Simmons & Company International, Research Division - Analyst of Oil Service***

And as far as potential working capital release being a benefit for you guys through the next few quarters, helping you guys generate some free cash flow with the load base. Can you just talk about your expectations there?

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Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Go ahead, Kyle?

Kyle P. O'Neill ***U.S. Well Services, Inc. - CFO***

Yes, sure. I mean I think, obviously, any time you come into markets like this, you see a kind of a huge release of your accounts receivable. I do think we'll see that balance work its way down, most likely, over the next -- yes, it -- I would think that it would largely be work -- that release will largely take place in the second quarter just given the timing of our payments. And then you'll see things kind of stabilize. So our ABL balance will come down. Obviously, we want to maintain plenty of liquidity and availability on the line. So I think you'll see both -- that balance come down as well as our ABL, but we'll still be able to continue to maintain adequate liquidity with a margin of error.

Dylan Gray Glosser ***Simmons & Company International, Research Division - Analyst of Oil Service***

Okay. And lastly, with the impairment charge, can you guys talk about your expectation for depreciation moving forward?

Kyle P. O'Neill ***U.S. Well Services, Inc. - CFO***

Yes. I mean I think that our DD&A will likely come down 20% or 30% going forward relative to our Q1 run rate.

Operator

We do do have follow-up question from the line of Stephen Gengaro with Stifel.

Stephen David Gengaro ***Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Analyst***

Just a follow-up. You mentioned, I think in response to my question about sort of $10 million on an e-fleet -- and $7 million on others. Are you -- when I think about the activity going forward, do you expect to be EBITDA positive in the second quarter?

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

We don't -- got you nearly. I don't -- not -- we don't want to provide guidance here, but yes, I do. We do expect to be EBITDA positive.

Operator

There are no further questions in queue. I'd like to hand it back to Joel Broussard for closing remarks.

Joel N. Broussard ***U.S. Well Services, Inc. - President, CEO & Director***

Thank you, all, for joining the call today, gentlemen. Appreciate it, ladies. Have a nice afternoon.

Operator

Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time, and have a wonderful day.

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